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FM AMEMBASSY JAKARTA
TO RUEHC/SECSTATE WASHDC 0887
RUEATRS/DEPT OF TREASURY WASHINGTON DC
INFO RUEHZS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RUEHRC/DEPT OF AGRICULTURE WASHINGTON DC
RUEHKO/AMEMBASSY TOKYO 2810
RUEHBJ/AMEMBASSY BEIJING 5698
RUEHBY/AMEMBASSY CANBERRA 3372
RUEHUL/AMEMBASSY SEOUL 5198
RUEHGP/AMEMBASSY SINGAPORE 6391
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UNCLAS SECTION 01 OF 02 JAKARTA 002206

SIPDIS
SENSITIVE

DEPT FOR EAP/MTS, EAP/EP AND EEB/IFD/OMA
TREASURY FOR IA/MALACHY NUGENT AND TRINA RAND
COMMERCE FOR 4430/KELLY
DEPT PASS FEDERAL RESERVE SAN FRANCISCO FOR CURRAN
DEPARTMENT PASS EXIM BANK
SINGAPORE FOR SBAKER
TOKYO FOR MGREWE
USDA/FAS/OA YOST, MILLER, JACKSON
USDA/FAS/OCRA CRIKER, HIGGISTON, RADLER
USDA/FAS/OGA CHAUDRY, DWYER
DEPT PASS USTR WEISEL, EHLERS

E.O. 12598: N/A
TAGS: EFIN EINV ECON EAGR ID
SUBJECT: BANK INDONESIA CUTS RATES TO SPUR GROWTH

REF: Jakarta 2140

¶1. (SBU) Summary. Bank Indonesia (BI) lowered its overnight policy rate by 25 basis points to 9.25% on December 4, surprising many market analysts. BI based the decision largely on Indonesia's rapidly deteriorating economic growth outlook, particularly as demand for Indonesian commodities falls. BI's policy statement also cited moderating domestic price levels as a key factor in the decision. While BI's rate cut is in line with the actions of most other central banks in the region, many observers had expected BI to maintain rates due to the rapid depreciation of the Rupiah (IDR) in recent weeks and the risk that the weakened currency could reignite inflation. A sharp drop in exports in October and the ongoing threat of capital flight continue to weigh heavily on the currency. The foreign exchange market reacted somewhat negatively to the mid-day decision, with the IDR losing most gains made earlier in the day to close at 11,900 IDR/USD on December 4. End summary.

Bank Indonesia Cuts Rate on Signs of Slower Growth

¶2. (SBU) BI lowered its overnight policy rate by 25 basis points due to the deteriorating outlook for economic growth and lower inflation in November. While third quarter 2008 growth remained robust (reftel), signs of significant slowdown in economic activity emerged in October and November. October exports declined 11.6% over the previous month and grew at a modest 4.9% over the previous year. Imports also declined on a month-on-month basis in October, but by a smaller margin, falling 5.9%. Poor export performance was attributed to weaker global demand for Indonesian commodities, including palm oil and rubber, as well as Indonesian manufactured goods, such as garments and wood products. October rubber and garment exports contracted the most dramatically, falling 172.5% and 95.1% (mom), respectively. Bank credit also showed signs of weakening in November, putting further pressure on the corporate sector, according to BI's policy statement. [Note: The policy statement did not cite the specific credit growth rate for November. End note.] In an effort to further increase liquidity in the banking sector, BI also raised its rate on overnight bank deposits by 50 basis points and lowered the overnight repo rate charged to

banks by 50 basis points on December 4.

¶3. (SBU) Consumer price inflation (CPI) continued to decelerate in November, increasing 0.12% (mom) and 11.68% (yoy), down from 0.5% (mom) and 11.8% (yoy) in October, providing room for policy easing, according to BI's December 4 statement. Basic food prices declined 0.14% (mom), as global commodity prices continued to slump. Transportation and communication prices also declined in November, dropping 0.31% (mom), due in large part to the temporary increase in transportation costs during the Idul Fitri holiday in October. Data from local markets collected by the Foreign Agricultural Service, indicate that the price of rice, cooking oil and soybeans declined in November, falling 2.6%, 19.3%, and 2.4% (mom), respectively.

Pressure on IDR Likely to Continue

¶4. (SBU) Market analysts have expressed concern that a policy rate cut could further undermine the value to the IDR and reignite inflation in the coming months. BI's policy statement recognized the significant depreciation in the IDR in recent weeks and the central bank pledged to continue to intervene in foreign exchange markets to smooth IDR volatility. The IDR is among the worst performing currencies in the region, falling more than 25% over the past two months. BI has not yet disclosed the level of its foreign currency reserves as of the end of November, making it difficult to determine the extent to which the central bank has intervened in currency market in recent weeks. Yet pressure on the IDR is unlikely to ease in the coming months, given signs of a deteriorating current account and the ongoing risk of capital flight. A recent Bank Danamon report noted that it would take

several months for the domestic prices of manufactured goods with high import content, such as apparel and pharmaceuticals, to reflect the weakened value of the currency. The foreign exchange market reacted somewhat negatively to the mid-day rate cut, with the IDR losing most gains made earlier in the day to close at 11,900 IDR/USD on December 4. A growing number of currency analysts are predicting that the IDR will weaken to 13,000 IDR/USD or beyond in the coming months.

HUME